September 12, 2018

MEMORANDUM

To: Central Health Board of Managers & Sendero Health Plans

From: Donna Novak

NovaRest was asked to review Sendero's financial projections for 2018 and 2019. We decided that the best way to proceed was to stress test the projections under a series of scenarios.

First, we reviewed the projection models and found them to be not inappropriate. The assumptions used in the models were within the range that we considered reasonable. We wanted to determine what the financial impact would be if reality turned out to be worse than assumed.

We understand that there is currently $20,000,000 in additional capital budgeted for Sendero. The additional capital is intended to cover 2018 losses and bring total risk-based capital (RBC) to 300% for 2018.

We received financials for 2018 through July 2018. To project the final 2018 losses, we tested two scenarios, first at a 90% medical loss ratio (MLR) for the remaining 5 months and another at a 105% MLR for the remaining 5 months. The MLR for the first 7 months was approximately 84% depending on final Advanced Premium Tax Credits (APTC). The first half of the year will have lower MLRs because individuals are still paying deductibles and have not reached their maximum out-of-pocket (MOOP). Therefore, in the second half of the year, the carriers pay a larger percentage of incurred claims. We felt that 105%, although not the worst loss-ratio that could conceivably happen, was the most likely high end. The following table shows the results of the 2018 stress tests:

Table 1 2018 Scenario Test, MLR from August-December 2018		
Item	**Scenario #1: 90% MLR**	**Scenario #2: 105% MLR**
Contributed Capital	$20,000,000	$20,000,000
Annual MLR - Medical Expense Total	88.6%	93.3%
Gain/Loss of Expense over Revenue	-$13,235,186	-$19,121,066
Ending Estimated RBC Ratio	361%	248%
Ending Capital (NET WORTH)	$18,718,278	$12,832,398
Additional Capital Required for 300% RBC	$0	$2,716,272

For a 90% MLR scenario, the result is a $13 million loss and a final RBC of 361%. For the 105% scenario, the result is a $19 million loss, a final RBC of 248%, and will require an additional $2.7 million contribution to bring RBC to 300%.

We also understand that in order to reduce the amount that Sendero pays in risk-adjustment[1], Platinum off-exchange plans will be offered to Medical Access Program (MAP) members. Since the risk scores for MAP members being targeted are significantly higher than current Sendero members, the addition of these members will increase Sendero's relative risk compared to the market and therefore result in Sendero receiving a risk-adjustment transfer rather than having to pay into the risk-adjustment system.

Changing Sendero's risk-adjustment position will increase profitability going forward, as Sendero will no longer have to make the large risk-adjustment payments that they have been making in the past few years. Risk-adjustment payments are not made until the following August after a calendar year to allow time for claims reporting and final calculations by the federal government. The delay in payments does impact cash flow. Sendero provided cash flow-projections that varied by the scenarios which we also stress tested.

There are a number of variables that will impact 2019 projections, which include:

- The projected non-MAP membership;
- The relative risk of the non-MAP membership;
- The projected MAP membership;
- The relative risk of the MAP membership.

[1] A risk adjustment payment is made when a carrier's risk is lower than the risk of the state's market as a whole, and conversely a risk adjustment receivable is made when a carrier's risk is higher than the market.

We started with a baseline scenario of 15,000 non-MAP members with a relative risk of 0.85. That is, the risk score of the non-MAP members is 85% of the Texas individual market in total. The baseline (Scenario #1) assumed 500 new MAP members with a relative risk score of 15 or 15 times the Texas individual market in total. We then ran scenarios for different relative risk scores for the MAP members, including a lower relative risk score of 10 (Scenario #2) and a higher relative risk score of 20 (Scenario #3). The results are in the table below.

Table 2
2019 Scenario Test, Impact to MAP Premium, Net Income, and Risk Adjustment Receivable

Item	Scenario #1: Baseline Estimate	Scenario #2: Decrease Relative Risk Score	Scenario #3: Increase Relative Risk Score
Non-MAP Members	15,000	15,000	15,000
MAP Members	500	500	500
MAP Members Relative Risk Score	15	10	20
MAP Premium	$8,149,140	$8,149,140	$8,149,140
Combined Statutory Net Income	$17,593,724	$11,065,002	$24,122,445
Combined Risk Adjustment Receivable	$24,463,532	$10,643,246	$38,283,818
Estimated RBC	623%	555%	677%

For these three scenarios the 2019 profits (net income) would be between $11 million and $24 million. The risk adjustment receivable amount ranges from a $10 million to a $38 million receivable. If the population has a very high risk score the risk adjustment receivable becomes too large and there may be cash flow issues in 2019.

The cost of the MAP premium of $8 million does not vary since the number of MAP members does not vary in these scenarios.

Next, we ran two scenarios varying the number of MAP members enrolled at the relative risk score of 15. Scenario #4 assumed 200 MAP members (compared to the baseline scenario of 500 MAP members) and Scenario #5 assumes 100 MAP members. The results are in the table below.

Table 3 2019 Scenario Test, Impact to MAP Premium, Net Income, and Risk Adjustment Receivable			
Item	**Scenario #1: Baseline Estimate**	**Scenario #4: Decrease MAP Members**	**Scenario #5: Decrease MAP Members**
Non-MAP Members	15,000	15,000	15,000
MAP Members	500	200	100
MAP Members Relative Risk Score	15	15	15
MAP Premium	$8,149,140	$3,259,656	$1,629,828
Combined Statutory Net Income	$17,593,724	$3,852,528	-$727,870
Combined Risk Adjustment Receivable	$24,463,532	$1,245,452	-$6,493,909
Estimated RBC	623%	453%	371%

As the number of MAP members decrease so does the MAP premium, the profitability, and the risk adjustment receivable with scenario #5 resulting in a risk adjustment payable. The number of MAP members is the largest controllable variable in 2019 profitability and may even be more important than the final risk scores of the MAP members enrolled, so long as they are significantly sicker than the base population. If the number of MAP members are too low, profitability is reduced and the risk adjustment transfer becomes a payable.

For the final scenario (Scenario #6), we increased the number of non-MAP members that enrolled in 2019, as seen in the table below.

Table 4 **2019 Scenario Test, Impact to MAP Premium, Net Income, and Risk Adjustment Receivable**		
Item	**Scenario #1: Baseline Estimate**	**Scenario #6: Increase Non-MAP Members**
Non-MAP Members	15,000	20,000
MAP Members	500	500
MAP Members Relative Risk Score	15	15
MAP Premium	$8,149,140	$8,149,140
Combined Statutory Net Income	$17,593,724	$19,824,301
Combined Risk Adjustment Receivable	$24,463,532	$19,719,109
Estimated RBC	623%	554%

Adding non-MAP members results in lower fixed cost per member increasing profits, but also results in the average risk being lower and therefore, the risk adjustment receivable is reduced.

Overall, assuming the $20 million financing contribution, we have evaluated scenarios of 15k to 20k non-MAP enrollees (approximately 1/2 to 1/3 lower than 2018), as well as scenarios of MAP membership from 100-500 members and MAP relative risk scores ranging from 20 down to 10 (half average score of sickest 1000) which should put Sendero between 370% and 680% RBC at December 2019. While a number of the projected RA receivables are high, much of it is covered by the reduction in RBC due to the reduction in membership. Also, the net income supports the receivable.

Appendix A: Definitions

Advanced Premium Tax Credits (APTC) – A tax credit taken by enrollee to lower monthly health insurance payment to the Affordable level as defined by the ACA. The enrollee will estimate yearly income when they apply for coverage in the Health Insurance marketplace. The APTC will be based on the estimate of the income entered.

Medical Access Program (MAP) – the Medical Access Program, which is the county indigent program 0-125% FPL.

Exchange or Marketplace Plan - A shopping and enrollment service for medical insurance created by the Affordable Care Act. In most states, the federal government runs the Marketplace (sometimes known as the "exchange") for individuals and families.

Maximum out-of-pocket (MOOP) – The most an insured has to pay for covered services in a plan year.

Medical Loss Ratio (MLR) – The percent of premium an insurer spends on claims.

Platinum Plan - Plans in the Health Insurance Marketplace are presented in 5 "metal" categories: Catastrophic, Bronze, Silver, Gold, and Platinum. A health plan will pay the highest percentage of health care expenses for the Platinum Plan.

Risk Adjustment - A method to offset the cost of providing health insurance for individuals—such as those with chronic health conditions—who represent a relatively high risk to insurers. Under risk adjustment, an insurer who enrolls a greater-than-average number of high-risk individuals receives compensation to make up for extra costs associated with those enrollees. Insurers who enroll less high-risk and more low-risk individuals relative to the average pays compensation to other carriers in the market.

Risk Score – A relative measure of the probable costs to insure an individual.

Stress Test – A process of evaluating various scenarios to determine an institution's reaction to different situations.